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Nos. 90-1361, 90-1484

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

HOLYWELL CORPORATION, *et al.*,
Petitioners,
v.

FRED STANTON SMITH, *et al.*

UNITED STATES OF AMERICA,
Petitioner,
v.

FRED STANTON SMITH, *et al.*

On Writs of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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REPLY BRIEF FOR PETITIONERS HOLYWELL CORPORATION, *ET AL.*

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INTRODUCTION

Respondents Smith and Bank of New York ("Bank") claim that the Bank's so-called "Plan of Reorganization" worked just as intended. The liquidating trustee was, they say, under no obligation to file tax returns or to pay any taxes. He was free to hold title to, liquidate, and distribute *all* of the debtors' assets, and to receive and distribute *all* of the income earned on those assets, without concern for federal capital gains or other income taxes. All that we may have here, they contend, is a little collection problem. In order to make this argument, they must tell an extended fairy tale.

That tale is that the Plan here was just a plain old corporate reorganization—and that when the Plan was confirmed, the corporations and Gould were sent forth to continue their operations just as before. We are supposed to think of the classic business reorganization in which new capital is infused and debts are stretched out or written down to manageable proportions so that they may be carried, going forward, by the "reorganized debtors," with perhaps a dollop of equity to the creditors to make up for the readjustment.

This Plan was nothing of the kind. It was a plan of *liquidation.*[1] As in any Bankruptcy Code liquidation, such as those under chapter 7, all of the nonexempt assets of the debtors were taken from them and used to pay creditors. Under the Plan, Smith became the owner of all their assets—he was vested with title to all of the property of the debtors' estates, sold the property in his own name,

[1] "Chapter 11 permits a plan of reorganization to provide for the sale of all or substantially all of the property of the estate. Such a liquidating plan enables a chapter 11 case to resemble closely a case under the liquidation chapter of the Code, chapter 7." 5 *Collier Bankruptcy Practice Guide* ¶ 90.04[4] at 90-24 (Asa S. Herzog & Lawrence P. King eds., 1991) (footnote omitted).

invested and reinvested the proceeds, and made distributions to creditors. J.A. 41; Pet. App. 3a, 19a, 30a. There was no forbearance exacted from the creditors, no scaling down of debts, no provision for debts to be paid only later out of the continued operations of the debtors, and no new capital contributed to finance ongoing business operations. The creditors were to be paid in full, with pre- and post-petition interest. The plan operated as a liquidation of the debtors' property, just as in the case of a conventional bankruptcy trustee acting under chapter 7 of the Code or by the debtors themselves as debtors-in-possession under a chapter 11 "liquidating plan."

But there was a key exception. Federal income taxes on the liquidation process were not to be paid! Rather than being afforded administrative expense priority under section 507 of the Bankruptcy Code, these taxes were—by the stroke of a pen—to be afforded no priority at all; indeed, no provision whatever for their payment was made. The clear intent of the Plan's sponsor was that the "reorganized debtors"—a couple of corporations reduced to shells and Gould, stripped of his assets—were supposed to pay the taxes. Instead of the taxing authorities being paid "off the top," they were to be paid off the bottom; and it was not planned that there would be anything at the bottom.

SOME OBSERVATIONS ON THE RESPONDENTS' STATEMENT OF THE FACTS

The Respondents' briefs both tell the same story about the supposititious "corporate reorganization."[2] We have

[2] Although Smith describes himself as a "stranger to the affairs of the debtors," Smith Br. 2, he certainly caught on fast. In October 1985, he demanded and received from the Bank an indemnity with respect to his actions as liquidating trustee. His then-counsel testified that Smith demanded the indemnity as protection from claims for the unpaid federal taxes at issue in this case. J.A. 168-71. Smith's substantive arguments after getting the indemnity have been closely aligned to those of the Bank, at least since his original counsel was replaced. Smith claims that we are making the argument that he is subject to personal liability in order to make him

quoted to us the rule that "the confirmation of a plan vests all of the properties of the estate in the debtor," Smith Br. 20 n.17, and are told that the debtors were "expected" to receive a substantial "residue." Bank Br. 20, 45. We are told that the Plan "assumed that after confirmation the individual and corporate debtors would conduct their own affairs," Smith Br. 6, and "continue to carry on business." Bank Br. 10. Finally, we are told that the liquidating trustee was simply "administer[ing] a fund," the contents of which we are not reminded of, "while regular corporate management continues to manage the corporation's business." Smith Br. 28, Bank Br. 19-20, 34. None of these elements of Respondents' "reorganization" fairy tale withstands scrutiny.

1. *"Continued Existence"*—We are told by Respondents that "like most plans of corporate reorganization, the Plan contemplated the continued existence of the corporate debtors." Smith Br. 31. In fact, the Plan contemplated the *liquidation* of the corporate debtors. Their continued technical existence as shell corporations, without assets, seems to have been the conceptual underpinning of the scheme which is now urged on this Court.[3]

We are presented with a list of the debtors' interests in "nonrelated businesses" (Bank Br. App.) and presumably invited to draw the inference that these interests did not pass to the liquidating trustee, but were retained by the "reorganized debtors." But under the Plan, they in fact passed to the liquidating trustee. Indeed, if the nondebtor corporations, the stock in which was acquired

"fear for his personal assets" in connection with his administration of the trust. Smith Br. 34. Obviously, his fear dates back to 1985, and was presumably soothed by the Bank's indemnity agreement. He has invoked the Bank's indemnity in this adversary proceeding. Complaint ¶ 18 (Smith Br. in Opp. 4, 6a).

[3] We are told that the corporate debtors have "of course retained whatever property they have accumulated since confirmation." Smith Br. 31. How shell corporations without assets go about "accumulating" property, we are not told. They have no wealthy uncles to leave them any.

by the trustee under the Plan, had any substantial assets, the liquidating trustee helped himself to them,[4] and used them to pay the creditors of one of the debtors, MCLP. No effort was made to pay Holywell's consolidated income taxes due the United States.[5] Although Smith makes the unsupported assertion that he "has been denied access to the assets of the nondebtor subsidiaries," Smith Br. 23, the truth is that he has, from the very beginning (and as contemplated by the Plan), seized control of *all* the assets of Holywell and its nondebtor subsidiaries.[6] Per-

[4] *See, e.g., Olympia & York Fla. Equity Corp.* v. *Bank of N.Y. (In re Holywell Corp.)*, 913 F.2d 873, 879-81 (11th Cir. 1990) ("the trustee acquired Gould's interest in" the joint venture); *Olympia & York Fla. Equity Corp.* v. *Bank of N.Y. (In re Holywell Corp.)*, 874 F.2d 780, 781 (11th Cir. 1989) ("all of the debtors' property was transferred to the liquidating trustee"), *cert. denied*, 110 S. Ct. 725 (1990); *Holywell Telecommunications Co.* v. *Bank of New York (In re Holywell Corp.)*, No. 85-3431, slip op. at 8-9 (S.D. Fla. May 24, 1989) ("the Liquidating Trustee . . . obtained Holywell's right to acquire the assets of [two Holywell subsidiaries] either by liquidating the two corporations or causing them to distribute a dividend to the Liquidating Trust"), *appeal dismissed*, 923 F.2d 865 (11th Cir. 1991).

[5] This notwithstanding the fact that, as Respondents acknowledge, these nondebtor wholly-owned subsidiaries of Holywell were severally liable to the United States with their debtor parent to pay the income taxes resulting from the "economic activity" being conducted by the liquidating trustee. The amounts trumpeted by Respondents (Smith Br. 5; Bank Br. 4) as paid to the United States by the liquidating trustee were for *payroll* taxes, not income taxes.

[6] *See* Order Approving Liquidating Trustee's First Report In Conjunction With Consummation Of Confirmed Plan (November 26, 1985) (Bankr. C.P. No. 1087) (showing the trustee in possession of all cash of Holywell's nondebtor subsidiaries). Time and again, the trustee has successfully asserted that he "owns" all assets of the debtors' estates, including Gould's interests in partnerships that were not themselves debtors and the accounts receivable of Holywell's nondebtor subsidiaries. *See, e.g., Olympia & York Fla. Equity Corp.* v. *Bank of N.Y. (In re Holywell Corp.)*, 913 F.2d at 879-81; *Holywell Telecommunications Co.* v. *Bank of New York (In re Holywell Corp.)*, No. 85-3431, slip op. at 8-9. To rebut these indisputable facts, the trustee points to a single, interlocutory court decision that, he admits, leaves unresolved his right to certain settlement proceeds. Smith Br. 7 n.6.

haps most misleading of all, Respondents speak repeatedly of the possibility of a "return" of the trust's "residue" to the debtors. Bank Br. 3, 4, 7, 16, 20, 45; Smith Br. 31.[7] Those suggestions are directly contrary to Respondents' contemporaneous representations to the bankruptcy court that there would be *no* assets left for the debtors.[8]

2. *"Separate Life"*—Smith relies on three anecdotes in an attempt to demonstrate a "separate life" of the debtors (Smith Br. 6-9); the Bank points to the same "evidence" in an effort to show that the debtors' "expectations" were that they would somehow resume "nor-

[7] This theoretical possibility is equally available under a chapter 7 liquidation. *See* 11 U.S.C. § 726(a)(6).

[8] On August 8, 1985—the day the Plan was confirmed—counsel for the Bank outlined the Plan's classification scheme to the bankruptcy court, explaining that Holywell's nondebtor subsidiaries would be paid only if there were money left over from the payment of all other creditors. Transcript (August 8, 1985) at 29 (Bankr. C.P. No. 908. Counsel then engaged in the following colloquy:

> THE COURT: What is going to happen to class 8 [the nondebtor subsidiaries], are they going to get anything or not?
>
> MR. SALTER: It appears to me, from the economics that I have seen, that they will not get anything—
>
> THE COURT: But you can't be certain?
>
> MR. SALTER: —but you cannot be certain because there are some very large claims, $6.1 million for Trusthouse Forte, and no one here knows exactly where that is going to shake out.

Id. at 29-30. Needless to say, the prospect of the *debtors* receiving a "residue" was even more remote. Indeed, on October 21, 1985, counsel for the Bank and the trustee each reaffirmed their views that Holywell was nothing but a "shell" and "an entity devoid of all of its assets." Transcript of that day at 9-12 (Bankr. C.P. No. 1061). Indeed, when the bankruptcy judge asked "[i]s there anything that would restrict or prevent [Gould] from continuing to do business under the name Holywell," counsel for the Bank explained that Gould could not do so because the Plan contemplated the trustee's possession of 100 percent of the stock and 100 percent of the assets of Holywell and its subsidiaries. He suggested, as an alternative, that Gould might wish to acquire the name "Holywell" from the trustee and use it to start a *new* company. *Id.* at 9-10.

mal economic activity" and pay the taxes on the trustee's liquidation activities from income realized from their new endeavors (those endeavors themselves, of course, also being taxable). Besides being irrelevant, this is unsupported nonsense.

First, respondents make much of the debtors' continued litigation (orchestrated by Gould and conducted in his own name, often *pro se*, and that of the corporations), as if these legal attacks on the Plan—and on what Respondents were doing under it—were somehow indicia of economic activity. Smith even annexes to his brief a complaint in a lawsuit against him by one of Holywell's nondebtor subsidiaries, Twin Development. Smith neglects to say that the outcome of that lawsuit was yet another reconfirmation that Smith—not Holywell or Gould—had "complete control" over Holywell's nondebtor subsidiaries. The district court held that "the trustee, having within the proper jurisdiction of the bankruptcy court all the capital stock of Twin, had the ultimate *complete control* of Twin Development. . . . That the course of dissolution was not undertaken may well have been because arrangements had been made to sell all of Twin Development's assets, with the remainder of the sales proceeds, after payments of debts and charges, being held in cash. The Plan of Reorganization required that remainder to be paid over to the trustee." *Twin Development Corp.* v. *Smith*, No. 87-0037-C, slip op. 12-13 (W.D. Va. November 15, 1988) (Ex. A to Dist. Ct. Doc. No. 33) (emphasis added).

Second, Respondents make the erroneous claim that the trustee cannot file the tax returns because the debtors have not provided Smith with the requisite financial records, and lament that the Plan granted the trustee "access to their records *only* 'regarding objections to claims.'" Smith Br. 6, 16, 31 (emphasis added); *accord* Bank Br. 4. In fact, the Plan requires the debtors to "comply from time to time with the reasonable requests of BNY, the Trustee[] and the Creditors Committees," J.A. 48, and to "take any and all actions" requested by the Bank

or the trustee, "whether or not specifically enumerated herein." J.A. 50, 48. And the bankruptcy court gave the trustee authority to "[r]eview and copy all books and records of the debtors and their respective subsidiaries, including all records relating to receipts and disbursements, all bank statements, checkbooks, ledgers, and other financial data." Order Appointing Trustee, App. 2a. The trustee undertook such review before the effective date of the Plan.[9] Moreover, as the 100 percent stockholder of these corporations, the trustee has the statutory right to demand access to their books and records.[10]

Third, Smith and the Bank point to the debtors' efforts to get the trustee to pay the taxes, quoting out of context two letters from Mr. Gould and one of his associates. Smith Br. 8-9, 32; Bank Br. 5, 17. These, they say, demonstrate the assetless debtors' "independence" and their "expectation" that they, and not the trustee, were to be responsible for the taxes.[11] The parties' state of mind is beside the point. The question before the Court

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[9] More recently, during the course of the Internal Revenue Service's examination of Holywell, the trustee's counsel requested information concerning the examining agent's determination of potential tax liabilities. *See* Bank Br. 44 n.40; Smith Br. 10 n.10. Counsel for Holywell repeatedly wrote to counsel for the trustee advising her that the trustee's representatives were free to examine Holywell's books and records. The trustee never acted on this oft-repeated invitation. The Internal Revenue Service has now completed its examination and provided copies of the revenue agent's final report on Holywell and its consolidated subsidiaries to the trustee; that report, the summary of which is reproduced as Appendix B, shows a federal tax liability of $21,641,190, exclusive of interest or any penalties, for the taxable years 1986 through 1991; the report also contains consolidated income statements for those years confirming that substantially all the consolidated group's income has been interest earned on assets in the hands of the trustee.

[10] Del. Code Ann., tit. 8, § 220 (1988); Fla. Stat. Ann. § 607.1601 to .1604 (West Supp. 1991); S.C. Code Ann. § 33-16-102(a) (Law. Coop. 1990); Va. Code Ann. §§ 13.1-771 to -773 (Michie 1989).

[11] The same is said to be true of the debtors' filing of Holywell's 1985 tax return shortly after Smith filed the complaint in this action, in an effort to identify the taxes at issue in the lawsuit.

is whether the applicable statutes require the trustee to file the returns and pay the taxes. In addition, Respondents' assertions about the debtors' state of mind are incorrect. Respondents point to no findings below to support those assertions; there were none.[12]

3. *"Disbursing Agent" Revisited*—The final element of Respondents' fairy tale is the notion that the trustee was a "limited-purpose fiduciary" (Bank Br. 38) whose "real task" was only to hold "specified assets" and "pay claims." Bank Br. 10, 38; Smith Br. 5, 30. The trustee was, as we have explained, vested with title to all property of the debtors' estates. He sold the bulk of that property in his own name. J.A. 168-69. He settled litigation between the bank and the debtors.[13] He possessed a full panoply of powers, J.A. 41-45, including the "absolute" power "to act or otherwise deal" with all property of the estates. He needed that power to sell the debtors' property, and he exercised it.

4. *The "Collection Problem"*—The Respondents, each in closing their briefs, say that the government's "collection problem" could have been prevented had it been a little more vigilant in objecting to the Plan. Smith Br. 43-48; Bank Br. 43-49. But if, as they say, the Plan's intent was lawful, what would there have been to object to? More fundamentally, the trustee cannot avoid the statutory obligations imposed on him when he assumed his office—whether or not the United States objected to the Plan from which he derived his powers. Respondents' ar-

[12] In truth, the documents demonstrate Gould's overriding concern that the reporting and payment of the federal income taxes be addressed responsibly by the trustee. For example, one such document is quite explicit in lamenting the trustee's stonewalling: "I do not understand how seventeen months have elapsed and this tax matter is still considered an open question and not resolved." J.A. 165; *see also id.* 166-67.

[13] *Holywell Corp.* v. *Bank of N.Y. (In re Holywell Corp.)*, 59 B.R. 340, 351 (S.D. Fla. 1986), *vacated sub nom. Miami Center Ltd. Partnership* v. *Bank of N.Y.*, 838 F.2d 1547 (11th Cir.), *cert. denied*, 488 U.S. 823 (1988).

guments are vestigial of the "mootness" argument made below and in the opposition to certiorari; that right or wrong, it is too late to complain now about what is revealed to be the true intent of the Plan or to apply the clear statutory mandate.[14]

ARGUMENT

This is a case controlled by multiple, overlapping acts of Congress regardless of the terms and intent of the Plan. Those statutes make the trustee a trustee for the United States with regard to the taxes at issue. *See* Holywell Br. 23. In our opening brief, we suggested that the Court rest its decision on the broadest of the applicable statutes, in order to give the taxing authorities effective relief in this case and to prevent replication of the present scheme in other cases. We therefore placed emphasis on section 960 of the Judicial Code, and on the Absolute Priority Statute, 31 U.S.C. § 3713, as well as on I.R.C. § 6012(b) and particularly on the term "assignee" in subsection (3).[15] Thirty-two States, the District of Columbia and the City of New York joined together to make clear their concern that an affirmance "will threaten the public fisc of the States," *Amici* Br. 2 n.1, and suggested that the Court rest its holding on section 960 be-

[14] Smith has not withdrawn his assertion that this Court "lacks jurisdiction because the issue is moot." Smith Br. in Opp. 1. And the Bank's argument on this point echoes almost word for word its "mootness" argument in opposition to certiorari, except that the Bank now fails to cite a single case in support of this argument. *Compare* Bank Br. 43-49 *with* Bank Br. in Opp. 12-16. For the reasons we set forth in our opening brief at pages 38-47, Respondents' reclothed "mootness" argument should be rejected.

[15] The applicability of section 960 was argued to the bankruptcy, district and appeals courts. *See* J.A. 91 (argument of counsel for the trustee that section 960 is inapplicable under now-overruled Eleventh Circuit precedent); Pet. App. 26a (district court's rationale for declining to apply section 960). Section 3713 was also pressed on those courts. *See* J.A. 89; Dist. Ct. Doc. 18 at 11; Court of Appeals Brief for Appellant United States (September 20, 1989) at 21. Smith's contention that the applicability of these statutes was "not pressed on the courts below" (Smith Br. 16) demonstrates a lack of attention to the record endemic in Respondents' briefs.

cause its plain language is even broader than that of section 6012(b). *Id.* at 4-5, n.2.[16]

1. *Section 960*—Section 960 subjects "[a]ny officers and agents conducting any business under authority of a United States court" to "all Federal, State and local taxes." Section 960, which is "plain on its face," embodies Congress' "express mandate" that the "paramount federal interest" in bankruptcy cases is the payment of "current tax obligations" in the ordinary course by court officers. *New Jersey* v. *Reading Co.*, 451 U.S. 918, 918-20 (1981) (Rehnquist, J., dissenting from denial of *certiorari*). Recently, the Court examined the language and legislative history of this statute in the context of state taxes imposed on the bankruptcy liquidation process and reaffirmed that its plain language requires the trustee "to pay rather than litigate these tax claims." *California State Bd. of Equalization* v. *Sierra Summit, Inc.*, 490 U.S. 844, 852 n.9 (1989). Since Smith's liquidation activities constitute "conducting any business" within the meaning of section 960, *id.* at 853, he is "subject to all Federal . . . taxes . . . to the same extent as if such business were conducted by an individual or corporation." 28 U.S.C. § 960. Sections 1 and 11 of the Internal Revenue Code impose federal tax on the income of individuals and corporations; by operation of section 960, Smith is "subject to" that tax on his liquidation activities. *See Nicholas* v. *United States*, 384 U.S. 678, 693-94 & n.27 (1966).[17]

[16] We do not disagree with the arguments made by the United States, but suggest that repetition of the scheme employed here through various mutations would be discouraged by taking the broader grounds which we underline: § 960; the broader of the language alternatives in § 6012(b)(3) and (4); and § 3713. As to sections 6012(b)(3) and (4), if the Court finds that the trustee falls both under the coverage of the references to title 11 trustees in those two subsections and under the more general language in them, the trustee should be estopped from claiming that he is a trustee in a case under title 11 and subjected to the consequences of falling under the broader language. *See* p. 20, *infra*.

[17] The lower courts have also recognized that section 960 imposes obligations on federal court officers to pay applicable *federal* taxes, such as the income taxes at issue here. *In re Samuel Chapman, Inc.*, 394 F.2d 340, 342 (2d Cir.), *cert. denied*, 393 U.S. 923 (1968); *Southern Ry.* v. *United States*, 306 F.2d 119 (5th Cir. 1962) (J. R. Brown, J.); *In re Inland Gas Corp.*, 241 F.2d 374, 384 (6th Cir.) (Martin, J., concurring), *cert. denied*, 355 U.S. 838 (1957). The two contrary cases cited by Smith (Smith Br. 40) erroneously made the distinction between "liquidating" and "conducting" business recently rejected by this Court in *Sierra Summit*. 490 U.S. at 851.

Respondents skip over the language of the statute and go directly to what they claim to be its "purpose," observing that section 960 was passed to "eliminate immunity for judicial officers" from state taxes and therefore has no bearing on federal taxes. Smith Br. 39-40; Bank Br. 42. It is so that the statute was first enacted (in a different form) to eliminate such immunity and originally applied only to "state and local" taxes. But Respondents ignore the amendment to the statute in 1948. That amendment added "Federal" taxes to the statute's coverage. Respondents' interpretation of the statute as negating "intergovernmental immunity" with respect to *federal* taxes cannot be correct, for there can be no intergovernmental immunity from federal taxes for a federal officer.

For the same reason, Respondents' attempt to distinguish *Sierra Summit* is unavailing. While it is true that *Sierra Summit* involved a claim of immunity from state taxes, the Court discussed how the statute is to be "[r]ead most naturally," what its "plain meaning" is, and whether it is to be applied to "the liquidation process." 490 U.S. at 851-53. The Court's careful elucidation of the meaning of the statute's "plain language," 490 U.S. at 853, is equally applicable to a situation like this one, where federal taxes are to be imposed on the income earned by a federal court officer conducting a liquidation. *See Nicholas* v. *United States*, 384 U.S. at 693-95 & n.27.

2. *The Corporate Debtors and Section 6012(b)(3)*—Section 6012(b)(3) requires the trustee to file the tax returns of the debtor corporations and, by operation of

section 6151(a), pay their taxes.[18] Most simply, he is an "assignee, by order of a court of competent jurisdiction, by operation of law or otherwise, [who] has possession of or holds title to all or substantially all the property or business" of Holywell. The Bank concedes that the courts have applied section 6012(b)(3) to the process of "corporate liquidation" and that "[a] liquidating corporation continues in existence for tax purposes . . ., and section 6012(b)(3) ensures that its return will be filed by the fiduciary in charge of its affairs, variously termed a 'liquidating receiver,' a 'trustee in dissolution,' or a *'liquidating trustee.'*" Bank Br. 38 (emphasis added). The Bank's argument that this provision is inapplicable here derives from its assertion that the corporations "have not been liquidated." Bank Br. 41. But that is a fundamental misrepresentation of the Plan's terms and effects. *See* pp. 2-8, *supra*. Once it is understood that Smith's duty was, in fact, to "hold, *liquidate*, and distribute" *all* the property of the estates (J.A. 41), the Bank's explanation of the early regulations and of the cases that apply the statute to receivers and assignees (Bank Br. 33-34, 37-41) fit this trustee like a glove.[19]

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[18] The great bulk of the unreported and unpaid taxes here are those of the corporations; we understand that the Internal Revenue Agent preliminarily determined that taxes attributable to Gould's individual estate for the period in which the Miami Center was sold were approximately $2 million, including penalties and interest. In contrast, the Holywell corporate federal liabilities appear to exceed $21,600,000 prior to penalties and interest (*see* p. 7 n.9, *supra*; pp. 4a-7a *infra*) and the Florida and Virginia liabilities to exceed $6 million.

[19] The Bank's fall-back argument is that the word "assignee" *actually* means "assignee for the benefit of creditors under State common law." Bank Br. 41-42. It is strange, then, that Congress said "assignee, by order of a court of competent jurisdiction, by operation of law, or otherwise"; language that is hardly so limited. The trustee, who took title to all of the debtors' estates' property, fits easily within the ordinary meaning of the term "assignee." Moreover, the expansive language following "assignee" clinches the matter: a common law assignment for the benefit of creditors is a private arrangement, rather than one that takes effect by court order or by operation of law, *see Brashear* v. *West*, 32 U.S. (7 Pet.) 608, 614 (1983), yet the statute mentions those two examples first.

Respondents urge a litmus test found nowhere in the statute. The test, they assert, is not whether Smith has "possession of all or substantially all the *property or business* of the debtors." Instead, they assert that the statute requires that he have "complete control" over the corporate shells by virtue of displacing their management, not just that he has taken over all the corporate assets. Smith Br. 25; Bank Br. 10, 41. This misreading of the statute flows from a mistaken application of *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417 (1932). The issue in *North American Oil* was not whether a liquidator had to "displace" management in order to be held liable to pay federal taxes, but whether he was in charge of the "*entire* property or business." 286 U.S. at 423 (emphasis added). The receiver in *North American Oil* controlled but one of the "many properties operated by [the company]," 286 U.S. at 420, and therefore was held not wit[illegible] the ambit of the statute.[20]

Again and again, Smith has succeeded in asserting that he owns all the assets of the debtors' estates. *See* pp. 3-6, *supra*. It is axiomatic that "[f]or federal income tax purposes, gain or loss from the sale or use of property is attributable to the owner of the property." *Commissioner* v. *Bollinger*, 485 U.S. 340, 344 (1988);

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[20] Smith's fall-back position, that the corporations must have been "formally dissol[ved]" (Smith Br. 29) exalts form over substance in a way neither suggested by the statute nor countenanced by the cases, as he must acknowledge in calling *Louisville Property Co.* v. *Commissioner*, 140 F.2d 547 (6th Cir.), *cert. denied* 322 U.S. 755 (1944), "an exception that proves the rule." Smith Br. 29 n.27. In truth, *Louisville Property* is indistinguishable from this case—the *Louisville Property* fiduciary was an "assignee" of all of the property of the corporation, "which was not dissolved." 140 F.2d at 548. *Louisville Property* belies Respondents' attempt to classify and categorize every court of appeals case in order to argue that this liquidation is unlike any that any other court has ever addressed. Those cases have consistently applied section 6012(b)(3), no matter how the fiduciary was appointed or came into possession of the corporation's assets.

accord Blair v. *Commissioner*, 300 U.S. 5, 12 (1937). This fundamental principle is given effect in section 6012(b)(3), which provides that Smith, having possession of and title to all the assets of the debtors' estates, must pay the taxes. In sum, the plain words of section 6012(b)(3) compel the trustee to file Holywell's returns because he has "possession of" and "title to" *all* of Holywell's assets and its then-business—liquidation activities.

3. *Gould's Individual Estate and Section 6012(b)(4)*—Section 6012(b)(4) requires the finduciary of an "estate, a trust, or an estate of an individual under chapter 7 or 11," to make the appropriate return. Respondents' attempt to escape application of this statutory provision rests on a wooden reading of the words "estate" and "trust." They assert that "estate" means only a "decedent's estate," and "trust" means only a "taxable trust under subchapter J of the Internal Revenue Code." *See* Smith Br. 21 n.18; Bank Br. 25. But there is no reason to give this statute such a narrow reading. The courts have recognized the existence of an equitable "estate" or constructive "trust" in situations like this one, where a fiduciary takes possession of the assets of an individual or corporation.[21]

Respondents erroneously suggest that in all cases only one return will be filed in regard to the income in respect of assets and transactions of an individual. While obviously only a single return will be filed in the case of a decedent's "estate" or that of an adjudicated incompetent, other situations arise where the income in respect of

[21] *See, e.g., Williams* v. *Commissioner*, 44 T.C. 673, 676 (1965) (assignee for the benefit of creditors under court supervision is treated as the "receiver" of an "estate" and is a "trustee for all the creditors"); *Mickelson* v. *Barnet*, 460 N.E.2d 566, 570-71 (Mass. 1984) (effect of transfer for benefit of specified creditors was to convey assets in trust); *In re Mader's Store for Men, Inc.* 254 N.W.2d 171, 177 (Wis. 1977) ("estate" created by assignment for benefit of creditors); *see also* 6A C.J.S. *Assignments for Benefit of Creditors* § 72 (1975) ("[t]he creditors are the beneficiaries of a trust created by the assignment"); *id.* § 89 (assignee for the benefit of creditors has "the duty to manage, protect and conserve the estate for the benefit of both the assignor and the creditors").

assets and transactions of an individual who has been stripped of his assets may, in effect, be the subject of two returns; one to be filed by the fiduciary who acquired control of his assets and the other, by the individual himself, in respect of any economic activity he engages in after the divestment of his assets. The provision of section 6012(b)(4) requiring a return for "an estate of an individual under chapter 7 or 11 of title 11" to be filed by the fiduciary is the most obvious example, and it is common ground that both this "estate," for its transactions, and the individual himself are to file returns. To assume that it is the only case of this sort is unwarranted. The same section requires returns for an "estate" or a "trust" by their fiduciary. Certainly an "estate" or "trust" derived wholly from the assets of the "estate of an individual under chapter 7 or 11 of title 11" would logically, as well as linguistically, be treated the same as such a bankruptcy estate.

While the Respondents deny that this case is covered by the reference to "an estate of an individual under chapter 7 or 11 of title 11" in section 6012(b)(4), the United States has answered that argument (U.S. Br. 33-36), and we do not disagree with the United States. But if we are to take the Respondents at their word, and say that the trustee is no longer administering "an estate of an individual under . . . title 11," it would still be the case that he was fiduciary of a "trust," albeit one wholly derived from an estate under title 11, or was administering an "estate" so derived; and "trusts" and "estates" are likewise covered by section 6012(b)(4).[22] This subsection of the statute is thus consistent with the requirement of separate returns from (1) the fiduciary upon whom all of the individual's property has devolved, and

[22] That the liquidating trustee is holding an "estate of Gould" has been recognized in this case; the District Court ordered that the repayment of certain loans made by Gould and Holywell be made "to the *estates* of Gould and Holywell." *Bank of N.Y.* v. *Holywell Corp.*, No. 87-0970-Civ-Kehoe, slip op. at 11 (S.D. Fla. Nov. 4, 1989).

(2) the individual himself, as to his ongoing activities after being stripped of his assets.

Respondents try to construct an argument from a concession by the petitioners that the liquidating trust was not *itself* a separate taxable entity. Bank Br. 26; Smith Br. 19 n.14; *see* J.A. 121. Clearly the liquidating trust could not be a separate taxable entity, because the liquidating trustee was at the same time serving as assignee of a number of corporations as well as the fiduciary of an estate or trust derived from Gould's individual estate in the bankruptcy case; the only question among the parties is who was responsible for filing the returns of these corporations and that estate or trust, and paying the taxes for them. A trustee administering various estates is, of course, required to keep separate accounts and may not use the assets of one to pay the taxes of another. *See Palmer* v. *Webster & Atlas Nat'l Bank*, 312 U.S. 156, 163-67 (1941).

It is a *non sequitur* to argue, as do the Respondents, that the petitioners' admission that the liquidating trust itself was not a taxable entity means that it was a "grantor trust." The grantor trust rules simply have nothing to do with section 6012(b). In fact, application of the grantor trust rules in this case would lead to a *reductio ad absurdum.* Respondents suggest that Gould himself be treated as the "owner" of the trust in respect of his bankruptcy estate. But of course Gould, the individual, did not contribute anything to the trust—the trust was funded by Gould's *bankruptcy estate*, a separate taxable entity. The *bankruptcy estate*, not Gould himself, would be treated as the trust's 'owner," under Respondents' theory. For that reason, *Collier* rejects the application of the grantor trust rules to bankruptcy cases. 1 *Collier on Bankruptcy* ¶ 8.02 at 8-16 (Lawrence P. King, *et al.*, eds., 15th ed. 1991).[23]

[23] In addition, Respondents fail to come to grips with the Ninth Circuit's holding that the grantor trust rules simply are not to be applied in the bankruptcy context because there has not been a "voluntary" transfer for the benefit of the transferor. *DePinto* v. *United States*, 585 F.2d 405, 407 (9th Cir. 1978) ("the very nature of the Bankruptcy Act is inconsistent with the requirements of the Grantor Trust provisions"). Here, the trust was not created by Gould's voluntary act but by order of a court over his strenuous objection. Every case cited by the Bank (Bank Br. 27) involved a *voluntary* transfer initiated by the transferor, including *Vreeland* v. *Commissioner*, 16 T.C. 1041, 1048 n.3 (1951). The comment in *Vreeland* that the same result would apply to an involuntary transfer is only *dicta* unnecessary to the holding and inconsistent with *DePinto*.

4. *The Absolute Priority Statute*—In Smith's effort to escape absolute personal liability for making distributions of tens of millions of dollars in disregard of the priority of the United States, it is necessary for him to claim that a single word appearing in interrelated statutes means different things and that Congress intended to create a gap between the two priority statutes—31 U.S.C. § 3713 and 11 U.S.C. § 507—without leaving a hint of its intention to do so in the statutory text or the legislative history. Section 3713 of title 31 contains two subsections. Subsection (a) affords claims of the government a first priority, except in "a case under title 11." Subsection (b) ensures enforcement of the government's priority by providing for absolute, personal liability for "[a] representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government."

The obligations of the trustee under section 3713 interlock with Internal Revenue Code section 6012(b)(3). If Smith is held to be "a trustee in a case under title 11," *id.*, then section 3713 is inapplicable. But if Respondents are correct that Smith is *not* a "trustee in a case under title 11," then section 3713 provides the government with a first priority and imposes absolute, personal liability on Smith. In short, Smith cannot have it both ways.

a. Respondents' contention that the United States is entitled to no priority at all for the taxes incurred when

Smith sold the Miami Center and invested the proceeds in interest-bearing accounts is sheer sophistry. They do not deny that Congress modified section 3713 to ensure that the priorities set out in section 507 of the Bankruptcy Code would be applicable in all bankruptcy cases. *See* Holywell Br. 31-32. Instead, they contend that these ordinary priorities were eliminated by a stroke of the pen —they were not incurred by a regular "trustee" but by a "contract trustee." Smith Br. 11 n.11, 38. Thus Respondents claim to have found a gap: these taxes are entitled to neither the Bankruptcy Code's section 507 administrative priority nor section 3713(a)'s first priority.

The legislative history shows an interlock, not a gap. Congress used the same words (case under title 11) in the Bankruptcy Code and the Internal Revenue Code to *include* situations within the scope of section 507's priorities (*see* 11 U.S.C. § 103(a)) that it used to *exclude* those situations in section 3713. The purpose of the 1978 revision was to abandon the approach of the old Bankruptcy Act, whose priority section incorporated nonbankruptcy priorities. *See* former 11 U.S.C. § 104.a(5) (1976) (Old Act § 64.a(5)). Thus, the trustee is either one thing or the other. If he *is* a trustee in a case under title 11, he should have filed the tax returns at issue and paid the taxes in accordance with the ordinary statutory priority afforded taxes on the liquidation process by sections 503 and 507 (and this Court should say so to prevent further attempts at evasion on remand). That is the basic position the United States takes, and it is well supported. However, the Court need not reach that conclusion to reverse the judgment below. Consistent with the long-standing interpretive tradition surrounding the Absolute Priority Statute (*see* Holywell Br. 22) the Court may take Smith at his word and hold that he is not a "trustee in a case under title 11." That would result in holding Smith personally liable for having paid private claims ahead of the taxes.

b. In attempting to escape the personal liability provision of section 3713(b), Respondents are in a quandary,

for they asserted that Smith is not a "trustee in a case under title 11." They therefore cannot and do not argue that the exception in the personal liability section, subsection (b), for a "trustee acting under title 11," covers Smith. Instead, they argue that the *entire* statute is inapplicable, stating that this *case* is a "case under title 11," that section 3713 *as a whole* does not apply in "a case under title 11," (citing, but not quoting, section 3713(a)(2)), and therefore that the personal liability provision in subsection (b) is inapplicable as well. Smith Br. 35-36; Bank Br. 42-43. Even assuming, *arguendo*, that subsection (a) is inapplicable, Respondents' logic is flawed. Section 3713(a)(2) states, in its entirety, "This *subsection* does not apply to a case under title 11." (Emphasis added.) Subsection (b), then, *does* apply in "a case under title 11," except to "a trustee acting under title 11." If we take Respondents at their word, Smith is *not* such a "trustee": they say that phrase is a "term of art" (meaning an administrative-phase trustee) and is "used consistently in titles 26, 28, and 31" as well as title 11. Smith Br. 26-27, 38; Bank Br. 29-33 & n.31.

Smith also asserts that bankruptcy court approval for his actions insulates him from personal liability. Smith Br. 42 n.36. Of course, *King* v. *United States*, 379 U.S. 329, 338-40 (1964), establishes that "court instruction and approval" does *not* insulate the trustee from liability under section 3713(b).[24] As this Court observed in *Mosser* v. *Darrow*, 341 U.S. 267, 274 (1951), "a trusteeship is serious business and is not to be undertaken lightly or so discharged. The most effective sanction for good administration is personal liability for the consequences of forbidden acts."

[24] Smith's reliance (Smith Br. 34 n.31) on I.R.C. § 6151 is also beside the point. It simply says that a fiduciary does not have to pay an estate's income taxes out of her own purse. It does not *insulate* Smith from liability imposed by statute or common law (*see* Holywell Br. 33 n.38) if he has wrongfully paid out money that should have been paid to the United States.

CONCLUSION

Because of the scheme at issue here, the federal and state governments have been deprived of their revenues in violation of the statutes. A construction of the statutes providing sanctions for the offenses against the federal fisc—based on the alternative arguments which we make—should be followed. If the trustee is held to be both a "trustee in a case under title 11" under section 6012(b)(3) and the analogous language in (b)(4) *and* also within the broader language in those sections—"assignee," "trust," etc., he should be estopped from claiming the exception in § 3713(b) for "trustees acting under title 11." This affords some prospect of enforcing the indemnity agreement and collecting the federal taxes from the real party in interest, the Bank.

Respectfully submitted,

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October 1991

APPENDICES

APPENDIX A

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA

Case No. 84-01590-BKC-TCB
84-01591-BKC-TCB
84-01592-BKC-TCB
84-01593-BKC-ACB
84-01504-BKC-TCB

IN RE: HOLYWELL CORPORATION, MIAMI CENTER LIMITED PARTNERSHIP, MIAMI CENTER CORPORATION, CHOPIN ASSOCIATES, and THEODORE B. GOULD,

Debtors.

ORDER APPOINTING TRUSTEE

[Bankr. C.P. No. 916; Trial Ex. 7]

On August 8, 1985 the Court entered an order confirming the Amended Consolidated Plan of Reorganization proposed by The Bank of New York (the "Bank's Plan"). Article V of the Plan contemplates the establishment of a liquidating trust and the appointment of a Trustee for all property of the debtors.

The Bank of New York has nominated Fred Stanton Smith to serve as Trustee under the Bank's Plan. In accordance with the discussions among counsel in open Court on August 8, Mr. Smith has been introduced to counsel for the debtors and Olympia & York.

In the interest of assuring an orderly transition from the debtors-in-possession to the Trustee, it is hereby ORDERED that:

1. Fred Stanton Smith is hereby appointed as Trustee for purposes of the Bank's Plan.

2. Since motions for rehearing are anticipated and will not be heard until next month, for the time being:

(a) the Trustee's compensation and expenses shall be borne by the Bank;

(b) The Trustee shall not assume title to, and possession and control of the debtors' property and affairs as contemplated by the Bank's Plan until such time, if any, as the motions for rehearing on the confirmation order have been heard and determined; in the interim, the Trustee and his representatives shall have the power and right:

(1) Upon notice to the debtors-in-possession, to enter upon and inspect the debtors' premises in order to become familiar with debtors' operations, including, without limitation, the Miami Center buildings and operations;

(2) Review and copy all books and records of the debtors and their respective subsidiaries, including all records, relating to receipts and disbursements, all bank statements, checkbooks, ledgers, and other financial data;

(3) Discuss the affairs and business operations of the debtors and their respective subsidiaries with the officers, directors, employees, attorneys, accountants, agents, tenants, subtenants, of such entities in order to gain a thorough understanding of such affairs and operations; and

(4) Engage attorneys, accountants, and such further consultants as he may deem appropriate, providing notice of such retention to parties in interest, for the purpose of analyzing the legal rights and financial position of the debtors and their respective subsidiaries.

3. On or before the date the Trustee assumes possession and control of the debtors' property and affairs pursuant to the Plan, the Trustee shall:

(a) File with the Court and serve upon all parties in interest a written statement describing the proposed basis for his compensation as Trustee and the identity of, and proposed compensation for, such attorneys, accountants, and consultants as have been retained by him. No compensation shall be payable to the Trustee or to any such attorney, accountant, or consultant from the assets of the debtors' estates until the Court has reviewed and heard any objections to such proposed compensation arrangements.

(b) Post a Trustee's bond in the amount of $1,000,000.00 in form approved by the Court. All payments of claims by the Trustee shall be approved by Court order.

DONE AND ORDERED at Miami, Florida, this 12 day of August, 1985.

/s/ Thomas C. Britton
THOMAS C. BRITTON
Bankruptcy Judge

cc: Counsel and Parties per
Attached Service List

APPENDIX B

SUMMARY SHEET (FIRST SHEET) OF REVENUE AGENT'S REPORT ON HOLYWELL CORPORATION AND CONSOLIDATED SUBSIDIARIES

[NOTES: (1) The Revenue Agent's Report as delivered to Respondent Smith and to Holywell is marked *"DRAFT"* and is not executed by the examiner. We understand that this has been done to avoid starting the 30-day period provided by Internal Revenue Service to initiate an administrative appeal, pending the Court's decision in this case.

(2) The computation of taxes on the Report does not include interest. With interest through October 1, 1991, the total liability for the consolidated group is approximately $32.3 million for the taxable year ending July 31, 1986, and approximately $2.8 million for the taxable years ending July 31, 1987 through July 31, 1991. Any applicable penalties and interest on them are likewise not included.]

Form 4549
Rev 7/81

DEPARTMENT OF THE TREASURY—INTERNAL REVENUE SERVICE
INCOME TAX EXAMINATION CHANGES

Return Form No.
1120

Name and Address of Taxpayers	S.S. or E.I.N.	Filing Status
HOLYWELL CORPORATION & SUSIDIARIES 2564-B IVY ROAD CHARLOTTESVILLE, VIRGINIA 22901	52-1070235	CORPORATION

Person With Union Changes Were Discussed

1. Adjustments to Income:	Year 07/31/86	Year 07/31/87	Year 07/31/88	Year 07/31/89	Year 07/31/90	Year 07/31/91
A. Taxable Income Before Net Operating Loss Deduction	60,499,881.00	459,299.00	930,237.00	914,183.00	1,959,691.00	3,019,226.00
B. Net Operating Loss Deduction	(14,270,398.00)					
C.						
D.						
E.						
2. Total Adjustments	46,229,483.00	459,299.00	930,237.00	914,183.00	1,959,691.00	3,019,226.00
3. Taxable Income Per Return	0.00	0.00	0.00	0.00	0.00	0.00
4. Corrected Taxable Income	46,229,483.00	459,299.00	930,237.00	914,183.00	1,959,691.00	3,019,226.00
5. Tax (From Page 2)	18,435,313.00	188,067.00	316,281.00	310,822.00	666,295.00	1,014,787.00

	Year 07/31/86	Year 07/31/87	Year 07/31/88	Year 07/31/89	Year 07/31/90	Year 07/31/91
6. Alternative Tax, If Applicable (from Page —)						
7. Corrected Tax Liability	18,435,313.00	188,067.00	316,281.00	310,822.00	666,295.00	1,014,787.00
8. Less: Credits:						
A. Investment Tax Credit (Page 2)	987,667.00					
B. Jobs Credit (from Page —)						
C.						
9. Balance	17,447,646.00	188,067.00	316,281.00	310,822.00	666,295.00	1,014,787.00
10. Plus:						
A. Tax From Recomputing Prior Year ITC	529,286.00					
B. Self-Employment Tax						
C. Minimum Tax (From Page 2)	1,168,006.00					
11. Total Corrected Tax Liability	19,144,938.00	188,067.00	316,281.00	310,822.00	666,295.00	1,014,787.00
12. Total Tax as Previously Adj	0.00	0.00	0.00	0.00	0.00	0.00
13. Deficiency (line 12-line 13)	19,144,938.00	188,067.00	316,281.00	310,822.00	666,295.00	1,014,787.00
14. Overassessment (line 13-line 12)						

15. Adjustment to Prepayment Credits						
16. Balance Due, Not including interest	19,144,938.00	188,067.00	316,281.00	310,822.00	666,295.00	1,014,787.00
17. Overpayment, Not including interest						
18. Penalties, If Any (see explanation)						

Other Information

Refer to pages 12 through 24 for a comprehensive statement of the facts of this case.

Examiner's Signature